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MEMORANDUM

To: Neelima Palacherla, Santa Clara LAFCO

From: Richard Berkson and Walter Kieser

Subject: Response to Winzler&Kelly Comments on the San Martin CFA; EPS #17060

Date: July 30, 2008

As you have requested, we have prepared responses to comments from Gary Thompson, of Winzler&Kelly, who has been retained by Rick van't Rood and the San Martin Neighborhood Alliance (July 8, 2008). As a part of this effort we have also been reviewing how to present information relevant to the revenue neutrality agreement and recommend a change to the existing **Table 3** in the CFA. While several of the comments cause us to make editorial changes to the CFA and clarifications, we are not inclined to make other substantive changes to our CFA revenue or cost estimates.

The comments are stated below, followed by our response.

General Fund

1. *Revenues retained by the County during the Transition Year (e.g., property tax and a portion of sales tax) should be credited against the repayment to the County for transition year services.*

   Response: Comment acknowledged. As indicated in the Draft CFA, certain revenues will not accrue to the new city during the transition year because of the timing of State filing deadlines; however, State law provides that the County repayment can deduct revenues generated within the area that would otherwise accrue to the new city. **Table 1** has been adjusted to show the reduction in revenues and offsetting reduction in repayment to the County.

   It is important to note that the timing of the effective date will affect the timing of revenues to the new city. In addition, **Table 1** assumes that the County provides credit for sales tax revenues received by the County any time after the effective date. This 100 percent credit is not clearly specified in the law; the State will not begin recording sales tax revenues to the new city until the quarter after they file and will not disburse the revenues until the following quarter after the sales are reported. The County will receive revenues in the first quarter for sales tax generated in the prior fiscal year, since the city sales tax filing will not be effective. As noted above, **Table 1** assumes that these revenues, received by the County in the new fiscal year after city formation, are credited towards the transition year cost repayment. Other CFAs in the State have taken the position that these sales tax revenues are retained by the County and not credited to the new city, since the sales taxes were reported and paid by unincorporated County businesses in the prior year. The resolution of this issue should be included as a term in the LAFCO terms and conditions and/or revenue neutrality agreement.

2. *The nomenclature for the "Property Tax/VLF Swap" line item should be changed.*

   Response: Comment acknowledged. This item is determined according to the AB 1602 allocation formula and should be so titled. **Table 1** will be revised, naming this line item "VLF (AB 1602)."

3. *Election costs are too high.*

   Response: The election costs are based on estimates provided by the County Registrar of Voters (April 2008) for a special election based on the election issue, elections for five council members, and based on the number of estimated voters. The Registrar of Voters provided to LAFCO additional documentation and explanation of the basis for the $50 cost per registered voter for the special election (July 14, 2008).

4. *The City Attorney cost is too high during the transition year.*

   Response: The cost estimates assume that a law firm is contracted to provide legal services. The first year of the city will require a substantial effort to create and adopt ordinances, negotiate contracts with service providers, and deal with transition issues including transfer of County roads, transfer of funds currently held by the County that will transfer to the new city, review and negotiation of leases, contracts with the County and other service providers, and employee contracts. Other issues that the attorneys may need to address include land use planning issues related to the airport and possible participation in the Habitat Conservation Plan currently under development by the County. Many of these issues apply to all new cities, whether large or small. While it may be possible to find a lawyer at a lower cost, it is assumed that the services of an experienced municipal law firm will be required. The estimate is based on our understanding of legal issues that may arise and a review of other newly incorporated cities (generally larger populations), including Rancho Santa Margarita, $212,500 in its first full year FY01; Aliso Viejo, $264,000 in its first full year FY03; Oakley $220,000 in its first full year FY01. CFAs prepared for Wildomar and Menifee Valley estimated $247,700 and $308,000 respectively for their first full year in FY10, growing in subsequent years.

5. *The city's $300,000 for General Plan costs is too high.*

   Response: Although the new city initially will adopt the County's General Plan, every new city formed in California has chosen to modify and adopt its own plan over the subsequent several years. Discussions with consultants indicate that these costs are $300,000 at a minimum and may be higher depending on environmental documentation, extent of changes, public participation and analysis. Although new development activity in the area is minimal, the residents of the new city may be motivated to address various land use planning issues related to the airport, development potential and status of currently vacant land, State affordable housing requirements, the Habitat Conservation Plan currently under development by the County, and interest in the potential revitalization of the community's commercial areas, including the potential for sewer service and its effect on future development.

6. *Transition Year City Manager and City Clerk non-labor costs appear to be overstated by $5,000 to $7,500. Transition Year Planning and Building costs appear to be overstated compared to the partial year forecast.*

   Response: The City Manager and City Clerk non-labor costs for a full transition year are double the corresponding costs for a partial transition year.

   The Planning and Building Department costs add a 0.25 full-time equivalent (FTE) planner position and 0.25 FTE Building Inspector/Code Enforcement position. The budget assumes that the city will hire these staff positions by the end of the Transition Year in order to help to provide for an orderly transfer of functions.

7. *Adjustments noted in the previous items would affect contingencies and reserves.*

   Response: Comment acknowledged. However, the comments regarding costs do not require any changes, in our opinion; thus, no change in the contingency item is necessary.

Road Fund

1. *Road Fund "other maintenance" costs provided by the County on July 1, 2008 are lower than the corresponding costs in the CFA.*

   Response: Comment acknowledged. We have independently derived the road maintenance cost estimate used in the CFA and believe the cost estimate to be representative, as a whole number, of the costs that the new city is likely to face. As to the composition of this cost estimate, the CFA road maintenance costs have been based on a cost categorization of County road maintenance data that differs from recent information provided by the County. In the future, the actual composition of road maintenance costs will vary for any number of reasons.

The current CFA road maintenance cost estimate has been adjusted by EPS to reflect the most recent data provided by the County for "miscellaneous" costs in FY07 of $229,613 and "weed abatement" costs in FY07 of $267,420, reduced by half (to $133,710), reflecting the County's estimate of future year costs and their assumption that they will be able to reduce historical costs for this item. The weed abatement costs have been factored downward by 50 percent in the city budget based on the County's estimate of reduced abatement costs because of the new city not being under the same injunction as the County against the use of certain herbicides.

The CFA's pavement management costs have also been reviewed in light of the County's revised data. The CFA was based on County estimates of road costs of $226,000. This cost was adjusted based on a review of other cities, and statements by County staff, that indicated that slurry seal treatments were a typical, lower cost method for maintaining roads. Recent County estimates for FY07 "typical" costs are $300,000 assuming chip seal treatments. EPS has contacted paving contractors and obtained estimates for costs for chip seal ranging from $0.25 to $0.30 per square foot. County staff indicated that it expects future costs for chip seal to be $0.35 (FY09); the EPS estimates picked a midpoint estimate of $0.30 per square foot as a basis for an FY07 cost.

After adjusting for the lower life cycle cost for slurry seal (refer to the CFA pages 20-23 for additional discussion) and adding a factor for other paving-related costs (i.e., sweeping, spot repair, traffic control and mobilization) based on a review of other cities, the resulting cost is $298,000 in FY07 terms, consistent with the recent County estimate. The additional factor is based on a midpoint of costs ranging from 15 percent (2007 bids received by the City of Woodland) to 50 percent estimated by the County. The budget projection to the first full year of the new city (FY11) includes a projection of four years of inflation (bringing existing cost estimates to then-current dollars) plus 1 percent annual increase, in addition to the 10 percent Road Fund contingency to address potential cost increases.

Revenue Neutrality

1. *Road Fund benefits should be credited against the County General Fund impacts when considering revenue neutrality.*

   Response: The issue of applying Road Fund benefits to the General Fund impacts has been addressed by prior analyses prepared by LAFCO's attorneys. We have also altered **Table 3** in the CFA to reflect the full cost of County road maintenance activities in the base year (FY07). While it is recognized that this expenditure is atypical, we believe that from a technical standpoint, and to be consistent with the Statute (Government Code Section 56800(a)) and the logic of the other numbers used in the revenue neutrality calculation, it is necessary to make this change. LAFCO, in making its determinations, can consider the anomalous nature of this particular cost item.

2. *No revenue neutrality payment should be required during the Transition Year.*

   Response: This comment is a negotiation position. The statute is not explicit on this point and thus it has been handled differently in previous incorporations. The County must be compensated for its expenses in the transition year. The question is whether or not there is an additional impact on the County during the transition period and if so, how should it be regarded and addressed either in the LAFCO terms and conditions and/or the revenue neutrality agreement.

7/23/08 DOES NOT INCLUDE REVENUE NEUTRALITY MITIGATION

Table 1
Summary of Revenues and Expenses (All Figures in Constant $'s)
San Martin Incorporation Analysis, EPS #17060 Full Transition Year 12 months Proponents' Proposed Boundary

Item	Fiscal Year 2009-10 1	2010-11 2	2011-12 3	2012-13 4	2013-14 5	2014-15 6	2015-16 7	2016-17 8	2017-18 9	2018-19 10
A. GENERAL FUND OPERATIONS										
General Fund Revenues										
Property Taxes	$0	$705,773	$724,107	$742,968	$762,367	$782,320	$802,841	$823,945	$845,646	$867,960
Sales Tax	$419,443	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885
Transient Occupancy Tax	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557
Real Property Transfer Tax	$5,305	$5,436	$5,571	$5,708	$5,849	$5,993	$6,141	$6,292	$6,447	$6,605
Franchise Fees	$289,670	$289,873	$290,075	$290,277	$290,479	$290,681	$290,883	$291,086	$291,288	$291,490
Planning and Building Fees	$0	$274,742	$276,116	$277,496	$278,884	$280,278	$281,679	$283,088	$284,503	$285,926
Public Works/Eng. Fees	$0	$89,020	$89,465	$89,913	$90,362	$90,814	$91,268	$91,724	$92,183	$92,644
Fines, Penalties, Misc.	$42,813	$32,684	$32,793	$32,901	$33,009	$33,117	$33,225	$33,333	$33,441	$33,549
State Motor Vehicle License Fees	$62,172	$62,377	$62,583	$62,788	$62,994	$63,200	$63,405	$63,611	$63,816	$64,022
VLF (AB1602)	$547,312	$512,513	$477,474	$442,193	$406,670	$370,907	$372,113	$373,320	$374,526	$375,733
Revenue Credits (transition yr, rec'd by County)	*revenues retained by County during Transition Year are credited to city repayment for Transition Year services.*									
Investment Earnings	$31,765	$60,657	$60,373	$60,094	$59,821	$59,555	$60,040	$60,537	$61,046	$61,567
Total	$1,620,038	$3,093,519	$3,078,998	$3,064,780	$3,050,878	$3,037,308	$3,062,039	$3,087,377	$3,113,339	$3,139,939
General Fund Expenses										
Legislative	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500
Elections	$200,000	$10,000	$0	$10,000	$0	$10,000	$0	$10,000	$0	$10,000
City Manager and City Clerk	$281,225	$328,659	$330,289	$331,927	$333,573	$335,227	$336,890	$338,561	$340,240	$341,928
City Attorney	$250,000	$76,131	$76,511	$76,894	$77,278	$77,665	$78,053	$78,443	$78,836	$79,230
Administrative Services	$166,050	$222,507	$223,620	$224,738	$225,861	$226,991	$228,126	$229,266	$230,413	$231,565
Police	$0	$588,661	$594,598	$600,594	$606,650	$612,767	$618,944	$625,184	$631,485	$637,850
Animal Control	$0	$74,811	$75,185	$75,561	$75,939	$76,319	$76,700	$77,084	$77,469	$77,856
Planning and Building	$137,672	$443,032	$444,635	$446,246	$347,864	$349,491	$351,126	$352,769	$354,421	$356,080
Public Works Administration	$74,250	$178,040	$178,931	$179,825	$180,724	$181,628	$182,536	$183,449	$184,366	$185,288
Non-Departmental										
Office Rent/Supplies	$109,000	$112,500	$84,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500
Insurance	$37,431	$61,915	$61,133	$61,554	$58,617	$59,283	$59,351	$60,023	$60,097	$60,774
Contingency (10%)	$233,596	$212,576	$209,890	$211,334	$201,251	$203,537	$203,773	$206,078	$206,333	$208,657
Reserve Fund Contribution	$233,596	($21,020)	($2,686)	$1,444	($10,083)	$2,286	$236	$2,305	$255	$2,324
LAFCO	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249
Repayment of Transition Yr Cnty Services (1)	($61,566)	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total	$1,692,001	$2,318,562	$2,307,355	$2,327,364	$2,204,923	$2,242,441	$2,242,983	$2,270,410	$2,271,162	$2,298,801
General Fund Operating Surplus (Deficit)	($71,963)	$774,957	$771,643	$737,416	$845,955	$794,866	$819,056	$816,967	$842,176	$841,138
Reserve Fund Balance	$233,596	$212,576	$209,890	$211,334	$201,251	$203,537	$203,773	$206,078	$206,333	$208,657
% of Expenditures (exc. conting, reserves)	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
B. ROAD FUND OPERATIONS										
Road Fund Revenues										
Gas Taxes	$200,789	$188,455	$176,036	$163,531	$150,940	$138,264	$138,692	$139,119	$139,547	$139,975
Prop 42 Funds	$63,687	$63,899	$64,751	$65,614	$66,488	$67,373	$68,268	$69,175	$70,094	$71,023
Total	$264,476	$252,354	$240,787	$229,145	$217,428	$205,637	$206,960	$208,295	$209,641	$210,998
Road Fund Expenditures										
Pavement Maintenance		$310,050	$313,150	$316,282	$319,445	$322,639	$325,865	$329,124	$332,415	$335,740
Signal Maintenance, Traffic Engineering		$51,008	$51,263	$51,519	$51,776	$52,035	$52,296	$52,557	$52,820	$53,084
Other Costs (sweeping, trash removal, signs, drainage)		$370,644	$372,497	$374,360	$376,232	$378,113	$380,003	$381,903	$383,813	$385,732
Contingency (10%)		$73,170	$73,691	$74,216	$74,745	$75,279	$75,816	$76,358	$76,905	$77,456
Repayment of Transition Yr Cnty Services	$0	$180,928	$180,928	$180,928	$180,928	$180,928				
Total	$0	$985,800	$991,529	$997,304	$1,003,126	$1,008,994	$833,981	$839,943	$845,953	$852,011
Road Fund Operating Surplus (Deficit)	$264,476	($733,446)	($750,742)	($768,160)	($785,698)	($803,357)	($627,021)	($631,648)	($636,312)	($641,013)
TOTAL, All Funds	$192,513	$41,511	$20,901	($30,744)	$60,257	($8,491)	$192,035	$185,319	$205,864	$200,125
Cumulative Surplus (Deficit)	$192,513	$234,024	$254,925	$224,181	$284,438	$275,947	$467,982	$653,301	$859,165	$1,059,290

(1) Repayment for animal services, planning and land use, code enforcement, public works, and sheriff services the County is obligated to provide for the remainder of the first fiscal year (less County-retained revenues).

7/23/08

Table 3
Change in Revenues and Expenses to Santa Clara County
San Martin Incorporation Analysis, EPS #17060 **Proponents' Proposed Boundary**

Item	Amount	Notes
<u>**General Fund Revenues and Expenditures (FY07) (1)**</u>		
Revenues Transferred to the City		
Property Taxes	$599,522	Estimated transfer amount FY 07
Transient Occupancy Tax	$221,557	
Sales Tax	$838,885	Includes estimated 12% unallocated
Real Property Transfer Tax	$2,335	50% of FY 07 amount ($.55/$1,000 value)
Franchise Fees	$253,621	Including solid waste, PG&E, cable, water
AB 939 Fees	<u>$10,237</u>	
Subtotal	$1,926,157	
Expenditures for Service Responsibilities Transferred to the City (1)		
Animal Control	$278,447	
Land Use Planning, Inspection, Enforcement	$151,056	
Clean Water	$3,186	
Waste Management	$129,205	
Sheriff	<u>$483,933</u>	
Subtotal	$1,045,827	
Other (revenue increases) (2)		
Property Tax Administration Fees	$8,090	Based on first year of city
Booking Fees	$0	Not paid by cities, per State budget
Net County Surplus or (Deficit)	**($872,240)**	
<u>**County Road Fund**</u>		
Revenue Reductions (3)		
Gas Tax: Highway User Tax 2106c	$27,491	Based on 7.7% reduction in unincorp. a.v.
Gas Tax: Highway User Tax 2105a [2]	$208	Based on reduction in County maintained miles
Grants		No reduction assumed
Traffic Congestion Relief: 2182a [1] (B)	<u>$41,624</u>	Based on reduction in County maintained miles
Subtotal	$69,323	
Expenditure Reductions		
Road Maintenance (4)	$1,502,235	Based on FY07 costs, noted as atypical (higher) of recent average road maintenance expenditures.
Other Road Costs (traffic engineering, signal maint.)	<u>$120,000</u>	Excludes cost-recovery development engineering
Subtotal	$1,622,235	
Net County Road Fund Surplus or (Deficit)	**$1,552,912**	
Total General Fund and Road Fund Surplus or (Deficit)	**$680,672**	**(5)**

(1) Costs shown in this table represent FY07 County costs for those service responsibilities to be transferred to the new city.
Future city costs shown in Table 1 will not necessarily correspond to these FY07 County costs since the specific future services, staffing, facilities, contracts and manner of service provision will differ for the future city. For example, the future city will need to provide traffic enforcement, which currently is not a County responsibility.

(2) The County will realize new revenues (e.g., property tax administration charges) for services currently provided without compensation.

(3) County road revenues are not significantly affected, as they largely depend on Countywide population and registered vehicles, and are not influenced by a change in unincorporated vs. incorporated population or road miles.

(4) Road maintenance expenditures are based on County estimates of FY07 expenditures. These costs are higher than the County's estimated average expenditures in the San Martin area and are above the estimate of average annual road maintenance costs that the new city is likely to incur.

(5) Legal requirements restrict the transfer of certain Road Fund revenues to the General Fund.
Legal counsel has indicated that LAFCO may consider the two funds in total when determining revenue neutrality impacts.